

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

U. S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
ENTERED
TAWANA C. MARSHALL, CLERK
THE DATE OF ENTRY IS
ON THE COURT'S DOCKET

IN RE: §
§
WINGS RESTAURANTS, INC. §
§
Debtor §
Case No. 03-31921 HDH-11

WINGS RESTAURANTS, INC. and §
HUGE AMERICAN REAL ESTATE, INC. §
§
Plaintiffs §
and §
§
SUNIL DHAROD, Individually and as §
Trustee of the SUNIL D. DHAROD §
REVOCABLE TRUST, and SHARMILA §
DHAROD §
§
Proposed Intervenor Plaintiffs §
§
VS. §
Adversary No. 03-3396
§
FLEET BUSINESS CREDIT, L.L.C. and §
KFC CORPORATION §
§
Defendants §

MEMORANDUM OPINION
REGARDING ORDER ON MOTION TO DISMISS

This matter is before this Court on a Motion to Dismiss Pursuant to Rules 12(b)(6) and 9(b) filed by Defendant, Fleet Business Credit, L.L.C. ("Fleet") on May 9, 2003. Fleet seeks dismissal of the adversary complaint that was filed against it on April 10, 2003, by Wings Restaurants, Inc. ("Wings"), the debtor in this bankruptcy case and plaintiff in this adversary proceeding, and by Huge

American Real Estate, Inc. (“Huge”), an affiliate and insider of Wings.

Background

In Spring, 2000, Huge and Sunil Dharod (“Dharod”), the principal of both Wings and Huge, began negotiating with KFC Corporation for the purchase of seventeen KFC restaurants in the Tulsa, Oklahoma area. Huge and Dharod entered into an Asset Purchase Agreement (“APA”) with KFC for the purchase of the seventeen restaurants. On October 2, 2000, Dharod assigned all of his rights under the APA to Wings. On October 10, 2000, Wings and KFC entered into seventeen separate Franchise Agreements for the restaurants, and on October 11, 2000, Wings and KFC executed seventeen separate Image Enhancement Agreements. Contemporaneous with the purchase of the restaurants from KFC, Wings and Huge executed a Loan and Security Agreement with Fleet pursuant to which Fleet agreed to provide approximately \$13 million in financing for Wings to purchase the KFC restaurants. Under the Loan and Security Agreement, Fleet agreed to make several loans to Wings and Huge, including a CapEx Loan to fund the upgrading obligations at the restaurants. In July 2002, Fleet declared Wings and Huge in default of certain non-monetary obligations under the Loan and Security Agreement for their failure to meet financial ratios and provide required financial information. In November 2002, Fleet alleges that Wings failed to make their loan payment to Fleet. Citing these and other defaults, Fleet accelerated the indebtedness under the Loan and Security Agreement and declined to make the CapEx loan. Wings and Huge allege that any of the defaults claimed by Fleet were timely cured “or could have been cured had Fleet acted reasonably and in good faith.” As a result of the failure of Fleet to fund the CapEx loan, Wings and Huge say they were unable to comply with the terms of the Image Enhancement Agreement with KFC. KFC issued a termination notice with respect to one of the restaurants (Restaurant No. 8) and

a default notice with respect to another (Restaurant No. 17).

In November, 2002, Fleet filed a complaint against Wings, Huge, and Dharod in the United States District Court for the Northern District of Oklahoma, styled *Fleet Business Credit, L.L.C. v. Wings Restaurants, Inc., Huge American Real Estate, Inc., and Sunil Dharod*, Case No. 02 CV 884P(J) (“District Court Action”), seeking (1) to enforce the terms of the Loan and Security Agreement, (2) to foreclose on the collateral, (3) damages against Dharod for breaches of a subordination agreement executed by him, and (4) the appointment of a receiver over the collateral pledged by Wings and Huge to secure the indebtedness to Fleet. By order dated January 30, 2003, KFC was granted permission to intervene as a plaintiff in the District Court Action.

On December 26, 2002, Wings and Huge filed an original answer in the District Court Action in which they denied Fleet’s claims, asserted numerous affirmative defenses, and asserted counterclaims against Fleet. Wings and Huge allege that their counterclaims “arise[] out of the same transaction or occurrence that is the subject matter of Fleet’s lawsuit against Defendants.” The Counterclaims consisted of claims against Fleet for breach of contract, negligent misrepresentation, and fraudulent inducement.

On February 20, 2003, Wings filed for relief under Chapter 7 of the Bankruptcy Code. On February 26, 2003, Wings converted the Chapter 7 case to one under Chapter 11. On March 12, 2003, Fleet filed, in the District Court Action, an Emergency Motion for Expedited Hearing on Appointment of Receiver Over Real Property of Huge American Real Estate, Inc. and Brief in Support, asking the district court in Tulsa to appoint a receiver over Huge. On April 10, 2003, the District Court appointed a receiver to collect and hold any rents paid by Wings to Huge during the pendency of the District Court Action. In the order appointing the receiver, the court addressed the

issue of whether Fleet's actions in seeking the appointment of a receiver over Huge (a non-debtor co-defendant in the Tulsa action) violated the automatic stay in this bankruptcy case. The court held that Fleet's actions against Huge did not violate the automatic stay. On April 11, 2003, Wings and Huge initiated this adversary proceeding against Fleet and KFC alleging breach of contract by Fleet and KFC (Counts II and III), tortious interference with existing and prospective business relationships and contracts by Fleet and KFC (Counts IV and V), economic duress (Count VI), fraud (Count VII), negligent misrepresentation (Count X), tortious breach of duty of good faith and fair dealing (Count IX), and conspiracy (Count XI) by Fleet and KFC, and violation of the automatic stay by Fleet (Count XII). Wings and Huge also asserted a claim for equitable subordination against Fleet (Count I) and sought a declaratory judgment that Fleet and KFC have breached the terms of their agreements with Wings and Huge, that Wings and Huge are not liable to Fleet or KFC, and that Fleet and KFC are liable to Wings and Huge for damages (Count VIII).

Fleet's Motion to Dismiss

Fleet seeks a dismissal of all of the claims against it in this adversary proceeding pursuant to Rule 12(b)(6) and Rule 9(b) of the Federal Rules of Civil Procedure, made applicable herein by Rule 7012(b) and Rule 7009 of the Federal Rules of Bankruptcy Procedure. Fleet seeks dismissal under Rule 12(b)(6) of the claims brought against it on the basis that all of the claims against it in this adversary proceeding are claims that have been, or should have been, brought against it as compulsory counterclaims in the District Court Action. Wings objects to the dismissal of its claims and argues that its claims against Fleet are "core" proceedings pursuant to § 157(b) of the Bankruptcy Code that must be heard by this Court. Wings argues that, therefore, its claims are not compulsory counterclaims that must be litigated as part of the District Court Action. Wings and

Huge also assert that Huge's claims against Fleet should not be dismissed, even though Huge is not a debtor, because (1) Huge's claims "are legally and factually identical in that Wings' and Huge's claims arise from the same agreement, under which Wings and Huge were jointly and severally liable . . . ,", (2) "if Huge is required to litigate its claims in the Oklahoma Lawsuit, there will potentially be different outcomes from two factually identical cases," and (3) Fleet would be able to recover any judgment against Huge from Wings, a debtor in this bankruptcy case.

The Court will first address Wings' contention that its claims are core proceedings and that "no other court may hear them; only this Court, which has jurisdiction over Wings' bankruptcy, can hear them." (Plaintiff's Response to Defendant Fleet Business Credit, L.L.C.'s Motion to Dismiss Pursuant to Rules 12(b)(6) and 9(b), p.4). A bankruptcy court, by reference from district court, has original and exclusive jurisdiction of all cases under title 11. 28 U.S.C. § 1334(a). It has original, but not exclusive, jurisdiction over "all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b). Section 157(b)(1) provides that "Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11" Absent consent of all parties, a bankruptcy court may hear matters that are non-core but otherwise "related to" the bankruptcy case, but may not enter final orders as to those matters. 28 U.S.C. 157(c). It is clear, then, that under § 1334(a), the only "proceeding" over which a bankruptcy court has exclusive jurisdiction is the petition itself. *See, In re Wood*, 825 F.2d 90, 92 (5th Cir. 1987). Thus, even if the claims asserted by Wings and Huge against Fleet in this adversary proceeding are "core" proceedings, they are not proceedings over which this Court has *exclusive* jurisdiction. *See, In re Directory International, Inc.*, 91 B.R. 738 (N.D. Tex. 1988)(rejecting debtor's argument that the district court, sitting as a bankruptcy court,

had exclusive jurisdiction over its claims in an adversary proceeding for breach of contract, fraud, violation of the Texas Deceptive Trade Practices – Consumer Protection Act, and breach of warranty because the Chapter 11 bankruptcy was filed in that district). Therefore, the issue of whether the claims asserted by Wings and Huge against Fleet constitute core proceedings is not determinative of the issue before this Court: should this Court exercise jurisdiction over these claims or should it dismiss them in favor of the prior pending District Court Action?

Count I, a claim against Fleet for equitable subordination under § 510(c) of the Bankruptcy Code, and Count XII, a claim against Fleet for violation of the automatic stay under § 362 of the Bankruptcy Code, are core proceedings that arise solely in the context of a bankruptcy case and are more properly tried in this Court in connection with the administration of Wings’ Chapter 11 case. Therefore, this Court will deny Fleet’s motion to dismiss as to those claims.

The remaining claims against Fleet should be dismissed under Rule 12(b)(6) if those claims are claims that have been, or should have been, brought as compulsory counterclaims in the prior pending District Court Action. These claims are contained in the following counts of the Complaint: Count II (breach of contract), Count IV (tortious interference with existing and prospective business relationships and contracts), Count VI (economic duress), Count VII (fraud in the inducement), Count VIII (declaratory judgment regarding the contracts), Count IX (breach of the duty of good faith and fair dealing), Count X (negligent misrepresentation), and Count XI (conspiracy). None of these claims invokes a substantive right provided by the bankruptcy code nor are any of these claims claims that, by their nature, could arise only in the context of a bankruptcy case. Rather, these claims are claims that could be enforced in a state court proceeding absent bankruptcy. Thus, the claims are simply non-core, “related to” proceedings over which this Court has jurisdiction to hear but no

authority to enter final orders absent consent of the parties.

Rule 13(a) of the Federal Rules of Civil Procedure, made applicable herein by Rule 7013 of the Federal Rules of Bankruptcy Procedure, provides, in pertinent part,

A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction.

In the District Court Action, Fleet brought claims against Wings and Huge seeking, *inter alia*, to enforce the terms of its contracts with Wings and Huge and to foreclose on the collateral securing its loans. Both Wings and Huge brought counterclaims in the District Court Action against Fleet for breach of contract, negligent misrepresentation and fraudulent inducement, stating that its counterclaim "arises out of the same transaction or occurrence that is the subject matter of Fleet's suit against Defendants." (Original Answer and Counterclaim of Defendants Wings Restaurants and Huge American Real Estate, p. 13, ¶ 3). Counts II (breach of contract), VII (fraudulent inducement), and X (negligent misrepresentation) of this Complaint are the same claims that have already been asserted by Wings and Huge in the District Court Action as compulsory counterclaims to Fleet's claims against Wings and Huge. Therefore, these claims should be dismissed.

The Court must now determine whether the remaining claims arise out of the same transaction or occurrence as the subject matter of Fleet's claims against Wings and Huge in the District Court Action such that they would constitute compulsory counterclaims in that action. In determining whether a claim is a compulsory counterclaim under Rule 13(a), the Fifth Circuit has applied a four part test in which the court should ask:

(1) whether the issues of fact and law raised by the claim and counterclaim largely are the same; (2) whether *res judicata* would bar a subsequent suit on defendant's

claim absent the compulsory counterclaim rule; (3) whether substantially the same evidence will support or refute plaintiff's claim as well as defendants' counterclaim; and (4) whether there is any logical relationship between the claim and the counterclaim.

Tank Insulation International, Inc. v. Insultherm, Inc., 104F.3d 83, 85-86 (5th Cir. 1997)(quoting *Park Club, Inc. v. Resolution Trust Corp.*, 967 F.2d 1053, 1058 (5th Cir. 1992)(citing *Plant v. Blazer Fin. Servs.*, 598 F.2d 1357, 1360 (5th Cir. 1979))). The Fifth Circuit stated that if *any* of the four tests were met, the counterclaim is compulsory. *See, Tank Insulation*, 104 F.3d at 86 (citing *id.*).

The remaining claims asserted by Wings and Huge against Fleet in this adversary proceeding are claims for tortious interference with existing and prospective business relationships and contracts (Count IV), economic duress (Count VI), declaratory judgment that Fleet has breached the Loan and Security Agreements (Count VIII), breach of duty of good faith and fair dealing (Count IX), and conspiracy (Count XI). In applying the four-part test announced by the Fifth Circuit to these claims, the Court finds that they are clearly compulsory counterclaims pursuant to Rule 13(a). Each of the claims arise out of the relationship between Wings, Huge, and Fleet that began with negotiations between the parties some time in the Spring of 2000. These negotiations culminated in Wings, Huge, and Fleet entering into a Loan and Security Agreement along with related loan documents under which Fleet advanced funds to Wings for the purchase and operation of seventeen KFC restaurants. Fleet filed suit against Wings and Huge in November, 2002, in the United States District Court for the Northern District of Oklahoma, alleging, *inter alia*, that Wings and Huge had breached the Loan and Security Agreement. Wings and Huge filed counterclaims alleging that Fleet had breached the agreements and that Fleet was guilty of fraud and negligent misrepresentation in connection with the negotiations leading up to the execution of the Loan and Security Agreement and in connection with Fleet's actions under the contract. Wings' and Huge's claims for tortious

interference, economic duress, declaratory judgment, breach of the duty of good faith and fair dealing, and conspiracy all arise out of the same negotiations and contract dealings as those that are the subject of the District Court Action. The issues of law raised by the claims in the District Court Action and this adversary proceeding are largely the same. A judgment in the District Court Action would likely be *res judicata* as to a subsequent suit brought by the Wings and Huge against Fleet regarding the same negotiations and contracts. The same evidence will support or refute Fleet's claim as well as Wing's and Huge's counterclaim. And, finally, there is clearly a logical relationship between Fleet's claims against Wings and Huge and Wing's and Huge's claims against Fleet because they are all based on the same negotiations and transactions between the parties. Thus, all four prongs of the Fifth Circuit's four-part test have been met. Because an affirmative answer to any one of the four questions would result in a finding that the claims brought by Wings and Huge are compulsory counterclaims, this Court finds that the claims asserted by Wings and Huge against Fleet in Counts IV, VI, XIII, IX, and XI of this adversary proceeding are compulsory counterclaims that must be brought in the District Court Action.

"It is well settled that a failure to plead a compulsory counterclaim bars a party from bringing a later independent action on that claim." *New York Life Ins. Co. v. Deshotel*, 142 F.3d 873, 882 (5th Cir. 1998); *see also, Directory Int'l, Inc. v. Bates Manuf. Co.*, 91 B.R. 738, 741 (N.D. Tex. 1988)("The failure to bring a compulsory counterclaim in a suit will bar the attempt to bring it in a subsequent suit.")(citations omitted). The Supreme Court has stated that Rule 13(a) was directed at just such a situation:

The requirement that counterclaims arising out of the same transaction or occurrence as the opposing party's claim 'shall' be stated in the pleadings was designed to prevent multiplicity of actions and to achieve resolution in a single lawsuit of all disputes arising out of common matters. The Rule was particularly directed against

one who failed to assert a counterclaim in one action and then instituted a second action in which that counterclaim became the basis of the complaint.

Southern Construction Co. v. Pickard, 371 U.S. 57, 60, 83 S.Ct. 108, 110 (1962)(citing *United States v. Eastport S.S. Corp.*, 255 F.2d 795, 801-02 (2nd Cir. 19)). Thus, a party who fails to bring a compulsory counterclaim may not avoid the mandates of Rule 13(a) by attempting to bring the claims in a subsequent proceeding. “When a compulsory counterclaim is brought as an independent action while the first action is still pending, the proper response is to dismiss, enjoin, or stay the second action.” *Directory Int’l*, 91 B.R. at 741 (citations omitted). Here, in the interest of judicial economy, and in deference to the prior filed action, this Court will dismiss the claims asserted by Wings and Huge against Fleet in Counts IV, VI, VIII, IX, and XI. As stated above, Counts II, VII, and X will be dismissed as well, as those claims have already been brought by Wings and Huge in the District Court Action as compulsory counterclaims against Fleet. Counts I and XII, for equitable subordination and stay violation, will be retained by this Court but stayed pending the resolution of the litigation in the District Court Action.

Because the Court has dismissed, under Rule 12(b)(6), the counts involving fraud and negligent misrepresentation, it need not, and does not, address Fleet’s motion to dismiss pursuant to Rule 9(b) regarding those claims. Accordingly,

IT IS ORDERED, ADJUDGED, AND DECREED that the claims asserted by Wings Restaurants, Inc. and Huge American Real Estate, Inc. against Fleet Business Credit, L.L.C. in Counts II, IV, and VI-XI of the Complaint be, and hereby are, **dismissed without prejudice**.

IT IS FURTHER ORDERED that proceedings in this adversary be, and hereby are, **stayed** pending the resolution of the litigation in the District Court Action or further order of this Court.

It is so ordered.

Signed this 11th day of August, 2003.



Honorable Harlin D. Hale
United States Bankruptcy Judge